

Federal Reserve Releases 2018 CCAR Results

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The Federal Reserve last week released the results of its [2018 Comprehensive Capital Analysis and Review](#) (CCAR). We have analyzed the 2018 CCAR results, along with the [Dodd-Frank Act Stress Test results](#) published the previous week, and have prepared a graphical summary available [here](#). As our summary shows, on average the stress losses for the firms subject to CCAR in 2018—measured by impact on CET1 risk-based capital ratios—were 33% higher compared to the 2017 CCAR cycle, evidence of the increased severity of the Federal Reserve's severely adverse supervisory stress scenario.

A total of 35 firms were subject to the 2018 CCAR assessments: 13 advanced approaches U.S. bank holding companies (BHCs), 10 non-advanced approaches U.S. BHCs, and 12 U.S. intermediate holding companies (IHCs) of foreign banking organizations. For the first time, U.S. BHCs with \$50 billion or more but less than \$100 billion in total consolidated assets were excluded from the CCAR assessment, consistent with the statutory change in the threshold for enhanced prudential standards under the Economic Growth, Regulatory Relief, and Consumer Protection Act enacted in May of this year. This change excluded three BHCs—CIT Group, Comerica and Zions—from this year's assessment.

The Federal Reserve did not object to the capital plans of 34 of the 35 firms. The Federal Reserve objected to one firm's capital plan on qualitative grounds and issued a conditional non-objection on quantitative grounds for three firms—Goldman Sachs, Morgan Stanley and State Street. For Goldman Sachs and Morgan Stanley, the Federal Reserve announced that it would not object to each firm's planned capital distributions so long as they are limited to no more than a benchmark amount equal to the greater of the firm's actual distributions made over the previous four calendar quarters and the annualized average of actual distributions over the previous eight calendar quarters. For State Street, the Federal Reserve stated that it has required the firm to take certain steps regarding the management and analysis of its counterparty exposures under stress. Four other firms—American Express, JPMorgan, KeyCorp and M&T Bank—took advantage of the opportunity to adjust their planned capital actions (the so-called "mulligan") after receiving the Federal Reserve's preliminary estimates for their post-stress capital ratios.

The Federal Reserve noted that each of the three firms receiving a conditional non-objection was projected to have at least one minimum post-stress capital ratio lower than the corresponding minimum required capital ratio, attributable in part to the adverse one-time accounting impacts of the Tax Cuts and Jobs Act (TCJA) enacted in December 2017. The Federal Reserve cited, among other factors, the one-time negative impact on these firms' capital ratios stemming from an overall favorable tax change, which the Federal Reserve noted was not indicative of the firms' performances under stress, as well as "uncertainties" in firms' capital ratios resulting from the timing of the TCJA—likely a reference to the timing of deferred tax assets and deferred tax liabilities. The conditions to the Federal Reserve's non-objections for Goldman Sachs and Morgan Stanley effectively limit these firms' capital distributions for the next four quarters based on a backward-looking benchmark, an approach consistent with the limitations imposed in past cycles for firms that did not meet post-stress minimum requirements and received quantitative objections (see, e.g., the limitations imposed on Zions in the 2014 CCAR cycle). We also note that five out of the six capital shortfalls (two for each of the three firms) related to Tier 1 leverage or supplementary leverage ratios, suggesting potential structural or conceptual inconsistencies with the use of risk-insensitive capital measures, which are intended as back-stops to the primary risk-based capital requirements, as post-stress minimum requirements.

The Federal Reserve also publicly identified the following three trends it observed in the capital planning practices of the 35 CCAR firms:

- For certain areas, such as credit cards, auto loans and revenues from certain business lines, the Federal Reserve noted certain inherent difficulties, such as lack of relevant data, in estimating stress losses or revenues. The Federal Reserve noted that some firms more than others were able to use “appropriate techniques” to overcome these challenges, although it did not publicly elaborate on the nature of the difficulties or its preferred techniques to address them.
- The Federal Reserve observed that some firms had “purchased large trading positions to offset the losses arising from the instantaneous market shock,” which we presume is a reference to the global market shock (GMS) scenario component to which six of the largest CCAR firms are subject. The Federal Reserve noted that this practice could be cause for concern if firms have not sufficiently analyzed the risk of these hedging strategies and subjected them to appropriate governance procedures. As an example of the type of risks from these strategies, the Federal Reserve pointed to the possibility that counterparties could be unwilling to make such hedging positions available during periods of market stress.
- The Federal Reserve also observed that many firms’ internal controls for capital planning fall short of supervisory expectations in various areas, including information systems and data management, capital planning audits, and model risk management.

About CCAR

CCAR is the Federal Reserve’s annual assessment of the capital planning processes of the largest U.S. BHCs – those with more than \$100 billion in total consolidated assets – and the U.S. IHCs of foreign banking organizations. CCAR includes a quantitative assessment under stressed conditions, which measures, over a forward-looking nine-quarter time horizon, whether the firm would meet minimum capital requirements (without capital buffers) under a hypothetical adverse and severely adverse economic scenarios assuming the implementation of the firm’s proposed capital action plan (i.e., its planned dividends, share buybacks and capital-raising actions over the nine-quarter horizon). In addition, CCAR includes for the 18 largest and most complex firms a qualitative assessment of the firm’s capital planning processes and management. If the Federal Reserve objects to a firm’s capital plan on either a quantitative or (if applicable) qualitative basis, the firm will not be permitted to distribute capital through dividends, share repurchases or other means, except as specifically approved by the Federal Reserve.

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